



**Comptroller of the Currency
Administrator of National Banks**

Washington, DC 20219

April 8, 1997

**Interpretive Letter #777
April 1997
12 U.S.C. 24(7)92**

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Dear []:

This responds to your request that the OCC concur with your view that national banks may invest in “trust preferred securities” as Type III securities, so long as they meet the applicable rating and marketability requirements of 12 C.F.R. Part 1.¹ Based on the information and representations provided, as described herein, we conclude that trust preferred securities may qualify as Type III securities.

Background

You represented that although each transaction may involve minor differences in terms, the basic structure of trust preferred securities is as follows. A corporate issuer (“Issuer Corporation”) organizes a business trust (“Issuer Trust”), usually under the Delaware Business Trust Act. The Issuer Trust issues two classes of securities: (1) common securities, all of which are purchased and held by the Issuer Corporation; and (2) trust preferred securities, which are sold to investors. The common and trust preferred securities issued by the Issuer Trust represent undivided beneficial interests in the assets of the Issuer Trust. The Issuer Trust’s only assets are junior subordinated deferrable interest debentures (“Debentures”) of the Issuer Corporation, which are purchased by the Issuer Trust with the proceeds from the sale of the common and preferred securities.

The Issuer Corporation executes a guarantee of the obligations of the Issuer Trust to pay distributions on the trust preferred securities (to the extent of available funds of the Issuer Trust), in addition to an agreement to indemnify third parties for other expenses and liabilities incurred by the Issuer Trust. Prospectuses for the trust preferred securities customarily provide that the Debentures, the guarantee, and the expense indemnity agreement, taken together, constitute a full, irrevocable and unconditional guarantee of the obligations of the Issuer Trust under the preferred securities.

¹Trust preferred securities are referred to by a variety of acronyms, such as “QUIPS” (which is a service mark of Goldman, Sachs & Co.).

You represent, for purposes of your position that trust preferred securities may be classified as Type III securities, that each trust preferred security and corresponding Debenture is:

- (1) Investment grade (as defined in 12 C.F.R. § 1.2(d)) or the credit equivalent of a security rated investment grade, and therefore is not predominantly speculative in nature (12 C.F.R. § 1.2(e)); and
- (2) Registered under the Securities Act of 1933, is offered and sold pursuant to Securities and Exchange Commission Rule 144A, or can be sold with reasonable promptness at a price that corresponds reasonably to its fair value. (See 12 C.F.R. § 1.2(f).)

The distributions the holders of the trust preferred securities receive from the Issuer Trust consist of the interest the Issuer Corporation pays on the Debentures. Thus the distribution rate on the trust preferred securities is identical to the rate of interest paid on the underlying Debentures.

The trust agreement provides that an event of default for the Debenture also constitutes an event of default for the trust preferred securities. In addition, if the Issuer Corporation defaults on its obligation to pay principal and interest on the Debentures when due and therefore funds are not available to pay the holders of the trust preferred securities, the holders of the trust preferred securities may sue the Issuer Corporation directly to enforce payment. The holders do not need to sue the Issuer Trust or the trustee. The holders of the trust preferred securities also may sue the Issuer Corporation directly to enforce their rights under the guarantee.

The Issuer Corporation may first redeem the Debentures after either five or ten years (depending on the terms of the Debentures) unless certain specified events occur.² The Debentures are not perpetual. If the Debentures are redeemed, the proceeds will be used to redeem the same amount of trust preferred securities. The redemption price is the stated amount of the trust preferred security plus a premium. The redemption price does not fluctuate with the market price of the security.

The voting rights of the holders of the trust preferred securities are very limited. The holders may vote only on issues relating to the modification of the trust preferred securities and the exercise of the Issuer Corporation's rights as holder of the Debentures and the guarantee. You represented that the trust preferred securities would be considered not to be voting securities, as the term is defined in 12 C.F.R. § 225.2(p).

You believe that the treatment of trust preferred securities as investment securities is consistent with the market's perception of these instruments. In discussions with Goldman, Sachs & Co. and other market participants, you have been advised that the institutional

²The Issuer Corporation must obtain any required regulatory approvals before redeeming the Debentures.

purchasers of trust preferred securities have been predominantly debt investors and that the trading characteristics are similar to traditional debt securities. You have also been advised that the New York Stock Exchange has listed at least one issue of trust preferred securities as a debt issue. In addition, the National Association of Insurance Commissioners has stated to you that it has generally determined trust preferred securities to be debt securities under the NAIC's six-factor test for "hybrid" securities.

Discussion

The national banking laws provide that a national bank "may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe." "Investment securities" are further described in the statute as "marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency." 12 U.S.C. § 24(Seventh). OCC regulations now define an investment security as "a marketable debt obligation that is not predominantly speculative in nature." 12 C.F.R. § 1.2(e). Type III securities are defined as "investment securities that do not qualify as Type I, II, IV, or V securities, such as corporate bonds and municipal revenue bonds." 12 C.F.R. § 1.2(k). The regulatory definition, therefore, is general and non-exclusive and relies on the substantive characteristics of an "investment security."

As described above, trust preferred securities are hybrid instruments. They possess many characteristics typically associated with debt obligations, such as corporate bonds and municipal revenue bonds, even though they are denominated as trust preferred securities. Like holders of debt, holders of trust preferred securities do not share in any appreciation in the value of the Issuer Trust, and are protected from changes in the value of the principal of the instruments (except for credit risk). Also, like holders of debt, the holders of trust preferred securities do not have voting rights in the management or the ordinary course of business of the Issuer Trust. In addition, like debt, trust preferred securities are not perpetual. Further, the distributions on the trust preferred securities resemble the periodic interest payments on debt. Finally, we understand that the SEC has indicated that it will not object to a bank holding company treating trust preferred securities as debt under Generally Accepted Accounting Principles (even if the bank holding company classifies these securities as minority interests in consolidated subsidiaries for regulatory reporting purposes). Thus, in substance, albeit not in their label, trust preferred securities are debt-like obligations.

This result is reinforced by the fact that an investment in trust preferred securities is functionally equivalent to an investment in the underlying Debentures, which you represent qualify as Type III securities. The holders of the trust preferred securities receive the same distributions that they would receive if they held the Debentures directly. Also, if the Issuer Corporation defaults on its obligation to pay the principal and interest on the Debentures when due so that funds are not available to pay the holders of the trust preferred securities, the holders of the trust preferred securities may sue the Issuer Corporation directly to enforce payment. In addition, an event of default for the Debentures also constitutes an event of

default for the trust preferred securities. Further, if the Issuer Corporation redeems the Debentures, the proceeds will be used to redeem the same amount of trust preferred securities. Because investment in the trust preferred securities is comparable to investment in the underlying Debenture, assuming that the Debentures qualify as Type III securities, the trust preferred securities may be purchased as Type III securities.³

Accordingly, we conclude that national banks may invest in the trust preferred securities as Type III investment securities if, as you represent, the trust preferred securities and the underlying Debentures are “marketable” and not predominantly speculative as required under OCC regulations defining investment securities.⁴ Banks that invest in trust preferred securities must comply with applicable regulatory requirements. If you have any questions, please contact Elizabeth Malone, Senior Attorney, at (202) 874-5210.

Sincerely,

/s/

Ellen Broadman, Director
Securities & Corporate Practices Division

³A national bank may invest in securities that are based on or derive their characteristics from other securities to the extent that it may invest in the underlying securities. *See, e.g.*, OCC Interpretive Letter No. 583 (April 27, 1992), *reprinted in* [1992-1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,404 (certificates constitute obligations of the United States and qualify as Type I securities based on underlying composition of certificates). Under similar reasoning, a national bank may buy shares in an investment company if the portfolio of the investment company consists exclusively of assets that the national bank may purchase and sell for its own account. *See* 12 C.F.R. § 1.3(h).

⁴ A security is not predominantly speculative in nature if it is rated investment grade or is the credit equivalent of a security rated investment grade. *Id.* A security is marketable if it:

- (1) Is registered under the Securities Act of 1933, 15 U.S.C. § 77a *et seq.*;
- (2) Is a municipal revenue bond exempt from registration under the Securities Act of 1933, 15 U.S.C. § 77c(a)(2);
- (3) Is offered and sold pursuant to Securities and Exchange Commission Rule 144A, 17 C.F.R. § 230.144A, and rated investment grade or is the credit equivalent of investment grade; or
- (4) Can be sold with reasonable promptness at a price that corresponds reasonably to its fair value.

12 C.F.R. § 1.2(f).